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IN THE

Supreme Court of the United States

OCTOBER TERM, 1941.

NO. 191

ROESER & PENDLETON, INC.,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI AND SUPPORTING BRIEF

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TO THE HONORABLE, THE SUPREME COURT OF THE UNITED STATES:

A STATEMENT OF THE MATTER INVOLVED

(The opinion of the Circuit Court of Appeals, Fifth Circuit, is reported in 118 F. (2d) 462, also in R. 138-142.)

This petition involves an important Federal question, concerning the right of a lessee, in making a sale of an oil property for a stipulated amount of cash and the retention of an "economic interest" in a

stated portion of the oil and gas in place — in the nature of an overriding royalty, that is free of operating expense — to claim the statutory 27½% depletion allowance on the cash received from such sale, treating such cash "as a return pro tanto of the seller's capital investment in such oil, in anticipation of its extraction." (*Palmer v. Bender*, 287 U. S. 551); with respect to which Federal question, Petitioner submits, the decision of the United States Circuit Court of Appeals for the Fifth Circuit (R. 138-142) is in conflict with the following applicable decisions:

First: Of the United States Court of Claims, in the case of *Heep Oil Corp. v. United States*, 32 Fed. Supp. 762, decided May 6, 1940, and,

Second: Of this Court in the case of *Palmer v. Bender*, 287 U. S. 551, as explained in *Collector Perkins*, 301 U. S. 655, and *Anderson v. Commissioner*, 310 U. S. 404,

in both of which decisions—*Heep Oil Corporation*, 32 Fed. Supp. 762, and *Palmer v. Bender*, 287 U. S. 551 —it was held that where one sells and assigns oil and gas leases for cash and the retention of a stipulated share in the oil and gas in place, or produced, until a stated sum of money is paid therefrom, such retained share constitutes an "economic interest" in the oil and gas in place, and that produced from operation of the leases, which entitles the seller to the statutory depletion allowance, not only on the retained interest, but as well, on the cash payment received, as a return pro tanto upon his invested capital, either actual or based upon discovery value; which holding is in conflict with the decision in the Fifth Circuit Court of

Appeals in petitioner's case, R. 138-142, as its decisions in the *Fleming Case*, 82 F. (2d) 324, and the *Laird Case*, 97 F. (2d) 730.

Third: Of the United States Circuit Court of Appeals, for the Ninth Circuit, in the case of *Elbe Oil Land Development Co. v. Commissioner*, 91 F. (2d) 127, in which this Court granted certiorari (303 U. S. 372; top p. 374) to determine an asserted conflict between the decision in that case, by the Ninth Circuit Court of Appeals, and a decision by the Fifth Circuit Court of Appeals, in the case of *Commissioner v. Fleming*, 82 F. (2d) 324 (see this Court's statement, 303 U. S., top page 374). This Court, in deciding the *Elbe Oil Company Case*, 303 U. S. 372, held that the facts in said case disclosed that the seller retained no "economic interest" in the oil in place, but on the contrary made an outright sale, with respect to which no depletion was allowable. Notwithstanding that this Court disposed of the *Elbe Oil Company Case*, 303 U. S. 372, by holding contrary to the Ninth Circuit Court of Appeals on the *fact issues involved*, the Ninth Circuit Court's opinion upon the *legal question decided*, assuming the facts were present, still stands, and it is in direct conflict with the Fifth Circuit Court's opinion in the *Fleming Case*, 82 F. (2d) 324, and petitioner's case, which is based upon and follows the Fleming Case, supra. (See comment by the Court of Claims in *Heep Oil Corp. v. United States*, 32 Fed. Supp. 762, decided May 6, 1940.)

The following are the salient facts:

On May 29, 1936 (R. 50-54) Roeser & Pendelton, Inc., sold and conveyed to Atlantic Oil Producing

Company, for $400,000.00 cash, but *subject to the oil, gas and mineral reservation next mentioned*, its undivided interests in eleven oil and gas leases, situated in the East Texas oil field, together with its interest in the material, machinery, supplies and other personal property used in connection with the operation of said leases (R. 50-51).

The May 29, 1936 conveyance (R. 50-54) contained the following reservation:

> "Except that Roeser & Pendleton, Inc. does hereby reserve unto itself, its successors and assigns, title to an undivided One-half (½) of the oil, gas and other minerals, in place, under, and produced and saved from the fractional leasehold interests of Roeser & Pendleton, Inc. described in said Exhibit 'A', attached hereto, until the said Roeser & Pendleton, Inc. shall have received from its said reserved undivided interest, as hereinbefore set out, either from all of the leases hereinbefore described, or from one or more of them, as provided for in paragraph twelve of the contract of May 13, 1936 between Roeser & Pendleton, Inc. and R. G. Trippett and A. H. Meadows, hereinbefore mentioned, the sum of One Million Two Hundred Thousand Dollars ($1,200,000.00), in accordance with the terms and conditions of the above referred to agreement of May 13, 1936, between Roeser & Pendleton, Inc. and R. G. Trippett and A. H. Meadows, which said agreement and the rights and privileges therein reserved by the said Roeser & Pendleton, Inc., are incorporated herein by reference and made a part hereof for all purposes, with the same force and to the same extent as if copied herein in full; after the receipt of which said sum of One

Million Two Hundred Thousand Dollars ($1,-200,000.00) said reserved interest shall ipso facto vest in Atlantic Oil Producing Company, its successors and assigns; whereupon, all rights of Roeser & Pendleton, Inc. under said contract of May 13, 1936, shall cease and terminate." (R. 51-52).

Among other covenants and agreements, set forth in said May 13, 1936 Roeser & Pendleton-Trippett and Meadows contract of sale (R. 71-84), referred to in the conveyance above mentioned, which the Atlantic Company bound and obligated itself to perform, and which were made a part, for all purposes, of said May 29, 1936 conveyance (R. 50), were the following:

1. That the assignments executed by R&P, in consummation of the contract of sale, should contain the reservation of title, by R&P in the oil, gas and minerals in place, as above set out. (par. a, R. 77).

2. That the reserved interest of R&P in each of the eleven leases, above mentioned, should continue not only until R&P realized the respective amounts of money, stated in the contract, from the reserved interest, with respect to each group of leases, but as well, until R&P received from all of said reserved interests, a total of $1,-200,000.00. (par. 12, R. 81-82).

3. That the reserved interest of R&P in said eleven leases, should not be liable or responsible for any operation, development or other expenses, except gross production and pipe line taxes, as to which it was agreed the amount of same should not be charged to R&P as having been

received by it on account of its reserved interest. (par. 13, R. 82).

4. That title to the properties covered by the contract might be taken either in the names of Trippett and Meadows, or their nominees and assigns. (par. 17, R. 83).

Messrs. Trippett and Meadows assigned all of their rights under the May 13, 1936 contract with R&P to J. K. Wadley (R. 29-31) who, in turn, assigned all of his interest in same to the Atlantic Company (R. 25-27).

The transaction between R&P and the Atlantic Company was consummated and carried out in accordance with the terms of the agreement. R&P received from the Atlantic Company the $400,000 in cash, as provided, and, from the effective date of said transaction, May 30, 1936, up to and including December 31, 1936, received from the "reserved interest," provided in the agreement, the sum of $69,301.30, less $1,643.09 production taxes, or the net sum of $67,658.21; which amount $67,658.21, was paid direct to R&P by the Pipe Line Company which ran and produced the oil and gas from the properties, pursuant to and in accordance with division orders executed by R&P.

R&P, in its 1936 Income Tax Return, claimed a 27½% depletion allowance on the entire $400,000 cash payment, received by it from the Atlantic Company. It subsequently conceded that this was erroneous, for, not all of the $400,000 received by it, represented an advance payment in anticipation of future production from the undivided leasehold interests sold to

the Atlantic Company, inasmuch as there was included in the sale, all of R&P's interest in the personal property situated on the leases, and used in connection with the drilling and operation of the wells thereon. (R. 102, Issue 2).

R&P, at the time of the sale to the Atlantic Company had invested in such equipment and personal property, after depreciation, previously allowed, a balance of $187,418.23. After deducting this amount from the $400,000 cash amount received, a balance of $212,-581.77 was left, representing, as petitioner views the matter, an advance payment on its reserved interest, in anticipation of future oil and gas produced from the leasehold interest sold and conveyed to the Atlantic Company (R. 40).

The Board of Tax Appeals denied petitioner's claim to the statutory depletion of 27½% on the $212,581.77 balance of the $400,000.00 cash received, (R. 102-103), basing its holding on the cases of *William Fleming*, 31 B. T. A. 623; affirmed Fifth Circuit, 82 F. (2d) 324, and *Roy H. Laird*, 35 B. T. A. 75, affirmed Fifth Circuit, 97 F. (2d) 730 (R. 102).

The U. S. Circuit Court of Appeals, for the Fifth Circuit, on petition to review the decision of the U. S. Board of Tax Appeals, sustained the latter's action in disallowing petitioner the 27½% statutory depletion on the $212,581.77 balance of the $400,000 cash payment received by R&P from Atlantic Oil, citing as authority therefor, *Commissioner v. Fleming*, 82 F. (2d) 324; *Laird v. Commissioner*, 97 F. (2d) 730; *Blankenship v. U. S.*, 95 F. (2d) 507; *Cf. Anderson v. Helvering*, 310 U. S. 404. For decision of Circuit

Court of Appeals see R. 138-142; also reported in 118 F. (2d) 462.

The date of the decision and judgment of the U. S. Circuit Court of Appeals for the Fifth Circuit was March 21, 1941 (R. 138, 143). Its mandate was stayed to June 21, 1941 (R. 147).

JURISDICTION OF THIS COURT TO REVIEW

A review of the Circuit Court of Appeals' judgment is sought by this Petition for Certiorari, under sub. (a) of Section 347, Title 28, U. S. C. A., which provides:

> "In any case, civil or criminal, in a Circuit Court of Appeals, * * * it shall be competent for the Supreme Court of the United States, upon the petition of any party thereto, * * * to require by certiorari, either before or after a judgment or decree by such lower court, that the case be certified to the Supreme Court for determination by it, with the same power and authority, and with like effect, as if the cause had been brought there by unrestricted writ of error or appeal."

The judgment of the Circuit Court was entered March 21, 1941 (R. 143), and the three months' period provided for in Section 350, Title 28, U. S. C. A., for the filing of this petition for certiorari in the Supreme Court, will not therefore expire until June 21, 1941, prior to which date this petition will be filed with the Clerk of this Court.

QUESTION PRESENTED

The sole question presented in this petition for certiorari is whether the U. S. Circuit Court of Appeals for the Fifth Circuit, in its opinion in this case, (R. 140-141) 118 F. (2d) 462, and in the *Fleming*, 82 F. (2d) 324, and *Laird*, 97 F. (2d) 730, cases, has correctly interpreted and applied the "economic interest" depletion rule announced by this Court in *Palmer v. Bender*, 287 U. S. 551, as explained in *Collector v. Perkins*, 301 U. S. 655, and *Anderson v. Commissioner*, 310 U. S. 404.

Under this rule, Petitioner contends that the controlling factor, in determining whether an owner or lessee, who executes or assigns an oil and gas lease, is entitled to the 27½% statutory depletion allowance on the cash received, is the *retention*, by the owner or lessee, of an interest in the minerals which remain to be produced (see Judge Dawkins' opinion in *Palmer v. Bender*, 49 F. (2d) at page 322, which was closely followed by this Court in the same case 287 U. S. 551). It is this *retained interest in the minerals, in place*, or a share in the minerals when produced, that constitutes "an economic interest in the oil, in place," and entitles an owner or lessee, in making a sale, to the 27½% statutory depletion allowance on the cash received.

On the other hand, Petitioner submits, the Circuit Court of Appeals for the Fifth Circuit, has consistently misconstrued and failed to follow the "economic interest" depletion rule, as above interpreted, adopted by this Court in *Palmer v. Bender*, 287 U. S. 551, as explained in *Collector v. Perkins*, 301 U. S. 655, and

Anderson v. Commissioner, 310 U. S. 404, by holding, in the *Fleming Case*, 82 F. (2d) 324, in the *Laird Case*, 97 F. (2d) 730, and in this case 118 F. (2d) 462 (R. 138-142), that the cash received by a lessee, in the sale of an oil property, where the lessee or seller retains an interest in the minerals in place, free of production expense, *constitutes a sale of a capital asset, which is not* subject to the 27½% depletion allowance. For instance, in the *Fleming case*, 82 F. (2d) 324, at page 327, the Fifth Circuit said: "The making of the sale depleted nothing. The money paid did not come actually, or in anyone's contemplation, from the production of oil, but was the purchaser's independent capital invested by him in the oil lease."

This erroneous view and conception of the "economic interest" depletion rule, entertained by the Circuit Court of Appeals for the Fifth Circuit, is diametrically opposed and runs counter to the fundamental logic upon which is based the reasoning of this court in *Palmer v. Bender*, 287 U. S. 551, as reflected in the following quotation from the court's opinion in that case:

> "The statute makes effective the legislative policy, favoring the discoverer of oil, by valuing his capital investment for purposes of depletion at the date of the discovery rather than at its original cost. The benefit of it accrues to the discoverer if he operates the well as owner or *lessee*, or if he leases it to another. It would be an anomaly if that policy were to be defeated and all benefit of the depletion allowance withheld *because he chose to secure the return of his capital investment by stipulating for a share of the oil*

produced from the discovered well through operation by another.

"The bonus received by the Smitherman partnership was a return pro tanto of the petitioner's capital investment in the oil, in anticipation of its extraction, resulting in a corresponding diminution in the unit depletion allowance upon the royalty oil as produced."

REASONS RELIED UPON FOR THE ALLOWANCE OF THE WRIT

Petitioner submits that the "economic interest" depletion rule, announced by this Court in *Palmer v. Bender*, 287 U. S. 551, has been sterilized and rendered impotent by the erroneous construction placed upon it by the United States Circuit Court of Appeals, for the Fifth Circuit. It is therefore of prime importance that this Court should take this opportunity, by granting the petition for certiorari here applied for, to review and place its own construction upon rule announced in *Palmer v. Bender*, supra, rather than to permit the Fifth Circuit to do so; thus dispelling the doubt, confusion and uncertainty that now exists in the minds of lawyers, Auditors and Judges as to the proper construction and application of said rule. For instance, Circuit Judge Foster, dissenting in the *Fleming Case*, 82 F. (2d) 328, said:

> "I think we should go further and allow a deduction for depletion on the cash payment, not dependent on the production of oil, since the taxpayer retained an economic interest in the oil in place; Palmer v. Bender, 287 U. S. 551. I therefore respectfully dissent."

Again, following the Fifth Circuit Court's decision in the *Fleming Case*, 82 Fed. (2d) 324, five members of the United States Board of Tax Appeals in the *Roy Laird Case*, 35 B. T. A. 75, declined to follow the Fifth Circuit's construction of the "economic interest" rule announced by this Court in *Palmer v. Bender*, 287 U. S. 551, their views being expressed in the following quotation from the dissenting opinion. (See 35 B. T. A. at pages 78-79):

> "I think the rule in such cases is that when the taxpayer retains an economic interest in the oil in place, the bonus or cash consideration, from whatever the payor's source, as well as the deferred payments from the oil, are gross income to the owner from that retained economic interest, and are, therefore, subject to the depletion allowance. Palmer v. Bender, supra; Herring v. Commissioner, supra; Burnet v. Harmel, 287 U. S. 103; Welch v. Obispo Oil Co., 61 Fed. (2d) 1045; Helvering v. Falk, 291 U. S. 183; Signal Gasoline Corporation v. Commissioner, 66 Fed. (2d) 886.
>
> "Here the retention of any 'economic interest in the oil in place' may be debatable. However, I agree with the Fleming case and the majority opinion of the Board here that the taxpayer did retain such an interest. Commissioner v. Elliott Petroleum Corporation, 82 Fed. (2d) 193; Chester Addison Jones, 31 B. T. A. 55; aff'd., 82 Fed. (2d) 329; Commissioner v. Williams, 82 Fed. (2d) 328; Alexander v. Continental Petroleum Co., 63 Fed. (2d) 927. *But, since he did retain such an economic interest, I think that the bonus, as well as the deferred payments, were income from the economic interest, and both are, therefore, depletable.*

Palmer v. Bender, supra; Herring v. Commissioner, supra." (Italics ours).

Further, and even more important, the United States Court of Claims, in the case of *Heep Oil Corporation v. United States*, 32 Fed. Supp. 762, on May 6, 1940, held absolutely contrary to the United States Circuit Court of Appeals, for the Fifth Circuit on the question here presented; in fact, refused to follow it; the pertinent portion of the Court of Claims opinion being as follows:

"We are further of the ponion that if it is entitled to depletion, this depletion must be computed with respect to the entire amount paid and not merely on the deferred payments to be made out of the oil produced.

"In Commissioner v. Fleming, 82 F. (2d) 324, the majority of the court in the Fifth Circuit held that depletion should be computed only on the deferred payments, on the theory that that part of the oil out of which the deferred payments were to be made had not been sold. Circuit Judge Foster dissented. The Ninth Circuit, on the other hand, in the case of Elbe Oil Land Development Company v. Commissioner, 91 F. (2d) 127, held that depletion should be computed both on the deferred payments and the cash payment as well. Judge Garrecht dissented, but not on this ground. The Supreme Court reversed the Circuit Court of Appeals (Helvering v. Elbe Oil Land Development Company, 303 U. S. 372, 58 S. Ct. 621, 82 L. Ed. 904), but on the ground that the transaction there was an absolute sale of the leasehold, with no reservations to the grantor of any economic interest in the oil situated thereon.

"If by the instrument in the case before us, properly construed, the plaintiff had conveyed all of the oil except a portion which it reserved to itself, it would follow that it was entitled to depletion only on the oil reserved, but, as we said heretofore, we think the conveyance here was of all the oil, except for the 1/32nd part of that produced from sands below the 3800-foot level. In such case, if plaintiff's net income is to be computed by the deduction of depletion from the amount received, rather than the cost of the property, it must be computed with respect to the entire amount received. The cash payment must be treated as a bonus or advance royalty. Burnet v. Harmel, 287 U. S. 103, 53 S. Ct. 74, 77 L. Ed. 199; Murphy Oil Co. v. Burnett, 287 U. S. 299, 53 S. Ct. 161, 77 L. Ed. 318."

* * * * *

It is significant that the Government did not risk losing what it had won, by the Fifth Circuit's holding in the *Fleming Case*, 82 F. (2d) 324, by applying for certiorari in the *Heep Oil Corporation Case*, 32 Fed. Supp. 762, nothwithstanding the respective holdings, on the identical question, are diametrically opposed.

* * * * *

Furthermore, there still remains undecided, notwithstanding the decision of this Court upon the *fact issues involved* (303 U. S. 372), the conflict between the decision of the Ninth Circuit Court of Appeals, in the case of *Elbe Oil Company v. Commissioner*, 91 F. (2d) 127, and the decision of the Fifth Circuit Court of Appeals in *Commissioner v. Fleming*, 82 Fed. (2d) 324, as well as in petitioner's case, which follows the

Fleming decision, upon the right of a seller to the statutory depletion allowance on a cash payment received, in the sale of an oil property, where the seller retains an "economic interest" in the oil and gas, in place, until a stipulated sum is paid from production.

This Court did not decide this conflict, although certiorari was granted in the *Elbe Oil Company Case* (see 303 U. S., top p. 374) on the ground of an asserted conflict between the decision in that case, by the Ninth Circuit, and the decision in the *Fleming Case*, 82 F. (2d) 324, by the Fifth Circuit. As previously stated, it was unnecessary for this Court to decide the conflict because this court found the facts were dissimilar. However the conflict is clearly raised in petitioner's case, and, if this Court thought it necessary (and it did—see 303 U. S., top page 374) to grant certiorari in the *Elbe Oil Company Case*, supra, to resolve the conflict (which as stated was not later decided because this Court found the facts were different) between the decision in that case, by the Ninth Circuit Court of Appeals, and the decision of the Fifth Circuit Court of Appeals in the *Fleming Case*, 82 F. (2d) 324, this Court should now grant certiorari in petitioner's case to resolve such conflict because petitioner's case follows and is based upon the Fleming Case, supra.

In addition to the foregoing, petitioner feels that the conflict between the decision of the Court of Claims in the *Heep Case*, supra, and the decision of the Fifth Circuit Court of Appeals, in this and the *Fleming Case*, supra, as well as the conflict between the decision of this Court in *Palmer v. Bender*, 287 U. S. 551, and the decision of the Fifth Circuit Court of Appeals in the

Fleming Case, supra, and this case should be resolved because the proper construction and application of the "economic interest" depletion rule, adopted by this Court in the case of *Palmer v. Bender*, 287 U. S. 551, is of such vital importance to the proper administration of the income tax law, with respect not only to the Government, but as well to the taxpayer, it should speedily be clarified and definitely settled; and this can only be accomplished by the granting of this petition for certiorari, and a review by this Court of the question presented.

WHEREFORE, Petitioner prays that, in the exercise of its discretion, this Court may issue its writ of certiorari to review the decision herein of the Circuit Court of Appeals, and for such other orders as may be appropriate.

Respectfully submitted,

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